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**Political Tie Heterogeneity and the Impact of
Adverse Shocks on Firm Value**

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Abstract

Past research has recognized the contingent value of corporate political ties but largely neglects their heterogeneity. Drawing on the political embeddedness perspective and literature on emerging economy political institutions, we develop hypotheses regarding how political networks comprising managerial and government ownership ties may have different valuation effects in the face of adverse political shocks. Examining stock market responses to an unanticipated, high-profile political event in China, we find a negative valuation effect of managerial ties to municipal government, but an insignificant effect of government ownership ties. Further, companies combining managerial and ownership ties experienced less post-shock reduction in market value than those holding only managerial political ties. These findings shed light on the values of different configurations of corporate political ties and inform firms of potential ways to manage ubiquitous political hazards in emerging economies.

Keywords: political tie, network embeddedness, tie heterogeneity, political risk, emerging economies, China

INTRODUCTION

Corporate political ties encompass a wide range of individual and institutional linkages between firms and public authorities (Okhmatovskiy, 2010; Sun et al., 2012). There is broad consensus in the literature that these ties can translate into higher profitability and market valuation (e.g., Hillman et al., 1999; Hillman, 2005). Yet prior research has also documented a darker side whereby politically connected firms suffer a substantial loss of firm value upon political shocks that cause a sudden removal of the power bases to which these ties were initially attached (e.g., Fisman, 2001; Siegel, 2007). Given such contingency of corporate political ties, an important and theoretically intriguing question has so far received little scrutiny: Are all politically connected firms equally vulnerable to adverse shocks?

This question is of particular relevance to firms operating in emerging markets. On the one hand, political ties may confer substantial returns to focal firms: Firms need political connections to guard against government extortions and obtain financial and regulatory resources at the government's disposal (Wright et al., 2005; Shi et al., 2014; Xu and Meyer, 2013). On the other hand, emerging economies are characterized by considerable sociopolitical pluralism and volatility, such that a variety of interest groups and factions compete for political and economic benefits (Henisz and Zelner, 2010; Kozhikode and Li, 2012). When erratic political rivalry leads opponents to dominate the political process, firms linked with the incumbent political group are at considerable risk of suffering from 'negative cascades of discrimination, resource exclusion, and even expropriation and sabotage' (Siegel, 2007: 625).

We address this risk-return duality by contending that not all politically connected firms are equally vulnerable to adverse political shocks, for they are typically embedded in a variety of ties to political actors and institutions. We draw on the political embeddedness perspective (Michelson, 2007; Okhmatovskiy, 2010; Sun et al., 2010a) to show that, in the presence of political hazards in emerging economies,

different types and combinations of political ties vary in their vulnerability and resilience to negative shocks, which generate different valuation impacts for focal firms. This variance stems in turn from distinct exchange processes and mechanisms underlying different political tie compositions. Specifically, we develop and test hypotheses delineating how specific compositions of political ties are associated with different valuation impacts arising from exogenous political events.

Most previous literature focused on a single type of dyadic ties between firms and governments. These ties range from personal-level linkages (Peng and Luo, 2000; Hillman et al., 1999) to organizational-level connections such as government ownership ties (Li et al., 2009; Inoue et al., 2013). We operationalize the personal-level investigation by focusing on managerial political ties involving political agents serving on top management teams (TMTs) and corporate boards. Comparatively less attention has been paid to the organizational linkages to political institutions. If firms are embedded in a particular political network, interorganizational connections can develop in the form of minority ownership stakes to state-owned enterprises (SOEs) or government agencies. These business-government ties may be deliberately created by government investment in private businesses or stem from residual government shareholdings after privatization (Inoue et al., 2013; Sun et al., 2010b; Vaaler and Schrage, 2009; Xu et al., 2014). No matter whether the formation of such ties is of a strategic nature or not, we know little about if and how adverse shocks affect firms holding government ownership ties.

Finally, there is emerging evidence that firms may hold a portfolio of personal and organizational ties with political groups (e.g., Dieleman and Boddewyn, 2012; Zhu and Chung 2014). However, literature explicitly studying the differences and interplay between managerial political ties and organizational ties through government ownership is lacking. As elaborated below, these two types of ties are not synonymous, in that the underlying mechanism regulating the exchange relations between firms and political actors (i.e., managerial political ties) is different from those between firms

and political institutions (i.e., government ownership ties). As such, it remains unclear whether personal connections and organizational linkages to the same political network function as complements or substitutes. An adverse political shock offers an important setting to disentangle the differences and examine the interplay between the two types of political ties.

We study political tie heterogeneity through an event study of China's most significant political shock in the 2000s, the arrest of the top Communist Party official in Shanghai on September 24 2006, which signified a sudden crackdown on the Shanghai-based political clique from the Chinese central government. Identifying all manager/board-level and ownership-level ties to the Shanghai municipal government, we investigate how different configurations of political ties impact the market value of Shanghai-based publicly traded companies. Our choice of a negative event yields insights not offered by conventional longitudinal analysis: The identification of a pivotal political event helps provide a more focused and contextualized analysis of the value of political ties in association with unexpected reversals of political fortunes. It complements longitudinal datasets which often lack such contextual and network-level specificity.

Our study makes two primary theoretical contributions. First, we add to general embeddedness research that calls for more multilevel studies to disentangle personal-level and organizational-level relationships (Kilduff and Brass, 2010; Zaheer et al., 2010) from the angle of political embeddedness. Rather than examining different types of ties in isolation, we account for the varying valuation impacts of different configurations of political ties. We offer a fine-grained analysis of how political network structure affects firm value in the face of political shocks in emerging markets, a context where institutional constraints on political actors are lacking. We elucidate the different exchange logics underlying personal-level and organizational-level political ties and achieve more nuanced understanding of how firms may address the risk-return duality of political ties in emerging economies.

Second, our study enriches understanding of political resources and capabilities embedded in corporate political ties. Given that possessing political resources embedded in a single type of political ties is insufficient to sustain competitive advantage (Bonardi, 2011; Sun et al., 2011a), firms may need a bundle of political ties that offer different types of resources and capabilities to navigate the complex political environment (Holburn and Zelner, 2010). Advancing the concept of political tie heterogeneity, we contribute to literature on corporate political resources (Dahan, 2005; Frynas et al., 2006; Oliver and Holzinger, 2008) by addressing the need to further theorize and empirically examine the roles of different types of political resources and capabilities in shaping corporate outcomes.

THEORY AND HYPOTHESES

Political Embeddedness and Political Tie Heterogeneity

Firms are embedded in networks of exchange relationships with other organizational actors to access requisite resources (Pfeffer and Salancik, 1978/2003; Granovetter, 1985). These interorganizational exchanges are not merely governed by arms-length transactions, but occur in the context of social relationships nurturing trust, commitment and reciprocity. Hence, social embeddedness characterizes the ways in which prior relations among actors both facilitate and constrain subsequent interorganizational exchanges (Barden and Mitchell, 2007). We treat political embeddedness as involving business-government exchange relationships realized by a multitude of individual and institutional ties to the state and its actors (Michelson, 2007; Okhmatovskiy, 2010; Sun et al., 2010a).

Interorganizational networks can be an important source of rent (Dyer and Singh, 1998; Gulati et al., 2000). That is, rent-generating resources may span firm boundaries and be embedded in network ties. This is consistent with research conceptualizing the

resources acquired by a firm through its ties to government bodies and politicians as ‘political resources’ or ‘political capabilities’ (Dahan, 2005; Frynas et al., 2006; Holburn and Zelner, 2010). Political ties confer legitimacy, information, and financial and regulatory resources to focal firms (Hillman et al., 2004). The use of relational political strategy is “akin to the development of social capital that is embedded in a continued exchange relationship between parties” (Hillman and Hitt, 1999, 829).

Interorganizational relationships are necessarily multilevel (Brass et al., 2004; Barden and Mitchell, 2007). ‘Nodal multiplexity’ of interorganizational ties suggests variation in the content and nature of relational experiences between organizations and the individuals that compose them (Barden and Mitchell, 2007). Specifically, exchange relationships arise at both the personal and the organizational levels. Despite the overlap of the two levels of embeddedness, current research calls for more multilevel studies that can isolate and compare the separate mechanisms governing personal and organizational ties respectively (Zaheer et al., 2010, 74). As such, understanding which exchange ties or what combinations of these ties matter when represents a crucial starting point for a general theory of network tie heterogeneity.

We aim to contribute conceptually by developing the idea of political tie heterogeneity at both personal and organizational levels of business-government exchanges, which hitherto has attracted little attention. At the personal level, corporate executives and political agents (e.g., politicians and bureaucrats) can exploit and develop reciprocal ties, which lead to formal linkages such as political actors sitting on the board/taking management positions and business people appointed to political positions.

At the organizational level, interorganizational ties are concerned with long-term cooperative relationships between organizations where each party retains its operational autonomy, examples being business groups, joint ventures, and strategic alliances (Brass et al., 2004). Viewed through this lens, firms and political institutions can have exchange relationships via ownership linkages. For example, government

may hold residual stakes in privatized firms for strategic reasons (Vaaler and Schrage, 2009); alternatively, government can invest in private businesses through business entities under its control (e.g., SOEs) to further collaboration with the private sector (Doh et al., 2004; Inoue et al., 2013). In addition, whereas majority state ownership will lead to loss of operational autonomy for focal firms, business-government networks can operate through minority government stakes in focal firms (Inoue et al., 2013; Okhmatovskiy, 2010; Vaaler and Schrage, 2009; Wang et al., 2012). Thus, we regard only minority shareholdings held by political institutions and/or SOEs as representing government ownership ties.

While the two types of embedded ties may be complementary, the distinction between the two cannot be neglected: Personal-level embeddedness involves the exchange of particularistic favors between economic and political agents, so that organizations can obtain requisite resources from political actors whose personal as well as organizational interests have been advanced by the social elite networks. Further, these business-government exchanges are susceptible to departures of politically-connected executives and board members, which may cause the termination of political ties and the dilution of political resources (Sun et al., 2012: 77). Organizational embeddedness, on the other hand, emphasizes the alignment of strategic goals between firms and political institutions, so that the state awards focal firms critical resources in exchange for firms' accommodation and support of the state's strategic objectives (Luo, 2001), which may or may not be congruent with those of the business and political agents. In what follows, we demonstrate how the distinct exchange logics governing the two types of political ties can yield different impacts on firm value resulting from adverse political shocks in emerging economies.

Political Shocks under Weak Institutions

The preceding account suggests a positive association between political ties and firm value: Both personal connections to prevailing political actors and organizational

linkages to political regimes help create a virtuous circle of favor and resource exchanges, translating into higher firm value through preferential regulatory policies (e.g., Bonardi et al., 2006) and financial resources (Inoue et al., 2013). Nevertheless, firm value generated via political connections may be lost overnight through exogenous shocks in the political environment. Such unexpected changes can quickly turn political assets associated with the incumbent sociopolitical network into liabilities, as the performance of connected firms in emerging economies may vary dramatically depending on the fortunes of their backers (Fisman, 2001; Siegel, 2007).

Despite recognition of such risk-return duality, we lack an explication of how political shocks may arise from interactions among the heterogeneity of political actors within individual firms' networks. That is, while shocks may be exogenous to a focal firm, they are oftentimes endogenous to the institutional environment where the firm resides. Therefore, firms need to develop deeper understanding about the nature of the shocks by treating the political actors as a collection of heterogeneous interest groups. Different sociopolitical groups and political parties compete for control of different branches of the state, especially in the weak institutional environment of emerging economies (Holburn and Zelner, 2010). Hence it is important to examine interactions among government agencies that may represent different interest groups.

While sociopolitical pluralism is present in developed economies, emerging market political institutions experience a key institutional weakness: a lack of institutional checks and balances that effectively constrain the discretion and opportunism of interest groups in power (Henisz and Zelner, 2010). Consequently, incumbent political interest groups both provide sizeable preferential treatment to firms with which they connect and can enforce dramatic discriminatory or wealth-redistribution policies against businesses connected to the disadvantaged groups. The value of corporate ties to a cohesive political group in power is vulnerable to shocks with the potential of shaking or even eradicating the network's power base. These shocks include unexpected election results, forced removal of a regime from office, and arrest and

conviction of powerful politicians.

Below we examine how a negative shock would differentially affect firms holding various types and combinations of political ties. This heterogeneity stems from the objectives of actors making up the tie and from different exchange logics underlying the tie. We develop hypotheses regarding the valuation effects by assessing and comparing the vulnerability and resilience of the ties to adverse shocks. While various configurations of political ties can create firm value under political stability, they will provide different signals to investors under conditions of adverse shocks. That is, the more resilient (or less vulnerable) a certain type or combination of political ties is to an adverse shock, the smaller the loss of market value for a focal firm post shock.

Managerial Political Ties

TMTs and boards of directors have long been central to dealing with organizational interdependence (Pfeffer and Salancik, 1978/2003). In the case of business-government relationships, managerial political ties provide opportunities for networking with powerful political actors, organizational legitimacy, information about the political process, and regulatory/financial resources controlled by political institutions and actors (Peng and Luo, 2000; Lester *et. al.*, 2008). On the other hand, developing managerial political ties entails considerable resource investment in relationship building and maintenance and obligations to reciprocate favors (Park and Luo, 2001). Further, the value of investing in nonmarket activities has a limit, beyond which the investment may jeopardize a firm's market activities (Bonardi, 2008). However, prior literature suggests that the benefits of managerial political ties tend to outweigh the costs (Hillman, 2005).

According to the political embeddedness perspective, long-term relationships between the two parties are not governed by arm's length transactions in which each seeks only to maximize short-term benefits. Whether they enter into the relationships for

instrumental purposes or not, the subsequent interpersonal networking allows trust and mutual indebtedness to develop beyond the original impetus for the relationships (Das and Teng, 2002). For both personal and organizational benefits, corporate executives can develop dense reciprocal relationships with incumbent political groups holding important government positions. In short, managerial political ties highlight enormous interpersonal attachments that result from ongoing business-government exchanges (Park and Luo, 2001).

When an unexpected shock destroys the power base of the sociopolitical network, the dense social relationships and interpersonal attachments will cease to create value for focal firms. Executives connected to the crumbling political network would suffer ‘guilt by association’, which refers to the economic or social punishment of a group or an organization for its prior relationships with illegitimate or disadvantaged individuals and social groups (Labianca and Brass, 2006). That is, managerial social capital accumulated before the shock turns into ‘social liabilities’.

Being personally involved with the old camp makes it difficult for a firm to prove its innocence and reconstitute the broken political ties in the near term. New political actors will seek to distance themselves from firms with ‘undesirable’ individuals connected to the past, as they attempt to send a public signal that the new political group is different from the previous one. Moreover, if the new political forces wish to extract rents from these firms and use them as sociopolitical instruments, the new players may treat those closely connected with their political opponents as a significant hindrance (Smith, 2009). Consequently, these firms will likely lose the protective shield and preferential treatment associated with the ousted group.

Finally, in a quest for their own legitimacy, incoming political actors may resort to overt discrimination against these firms. This adverse effect can be exacerbated by the lack of institutional checks and balances on the discretion of political leaders. Paucity of political and legal constraints makes it easy for politicians to punish these firms, so

long as they have adequate socioemotional and/or economic motives. Thus, the stronger the firm's personal-level linkages to the ousted group, the more susceptible the firm will likely be to the potential negative effect:

Hypothesis 1: In the face of adverse shocks on a corporate political network, the stronger the managerial ties to this network, the greater the loss of firm value.

Government Ownership Ties

Under political stability, the presence of minority government stakes can send a signal to investors about the focal company's access to crucial resources at the government's disposal. With respect to residual government stakes in privatized companies, continued government involvement can assure private investors of state support for the firm (Vaalar and Schrage, 2009). When it comes to state investment in *de novo* projects, the government can serve as a 'venture capitalist' supplying long-term equity finance and legitimacy/reputation to attract further business partners and resource inflows (Inoue et al., 2013).

In the face of a negative political shock, we expect firms with government ownership ties, linked via minority government shareholdings, to suffer much less, if any, from 'guilt by association' and thereby to experience insignificant discriminatory activities from the incoming political group. This is because the underlying mechanism regulating business-government interaction is different from that relating to managerial political ties. Specifically, firms connected through ownership ties tend to accommodate economic and social objectives of political institutions in return for scarce resources and policy favors (Luo, 2001; Sun et al., 2010a).

While interpersonal interactions are present in the development and functioning of government ownership ties (Park and Luo, 2001), this process will *ceteris paribus* generate fewer interpersonal attachments and socioemotional elements characteristic

of managerial political ties. On the other hand, the strength and durability of interorganizational ties hinge upon the degree of resource interdependence between the two parties and the availability of alternative partners (Pfeffer and Salancik, 1978/2003; Westphal et al., 2006). That is, ownership ties will remain instrumentally valuable to incoming elites if these firms remain well-functioning and can help achieve their financial and sociopolitical goals. It is therefore unlikely that new political actors conduct self-cannibalization by excessively punishing them.

Finally, ownership ties may be harder to terminate than managerial ties (Calomiris et al., 2010). Feasible alternatives are not always easy to find, and the financial and institutional constraints of quickly dissolving existing ownership ties serve to maintain the interorganizational linkages. Overall, the above arguments lead to the following hypothesis:

Hypothesis 2: In the face of adverse shocks on a corporate political network, government ownership ties to this network through the holding of minority ownership stakes in focal firms will have a negligible effect on firm value.

Interaction of Managerial Political Ties and Government Ownership Ties

So far we treated managerial and ownership ties separately. Under political stability, the elite group in power also controls government agencies, so there can be considerable overlap between personal and organizational exchanges between firms and the state. This is particularly the case for firms simultaneously holding managerial and ownership ties to the prevailing political regime. The interplay of the two types of political ties is important but has been neglected by prior research.

The social embeddedness literature suggests that multiple ties between two parties can strengthen dyadic reciprocation and symbiotic interdependences (Barton and Mitchell, 2007). In the context of business-government exchanges, managerial/board

networking with political actors can further enhance the benefits offered from ownership linkages to political institutions. They can reinforce each other to facilitate greater and speedier flow of regulatory and financial resources to focal firms (Park and Luo, 2001). This complementary effect is especially salient in emerging economies, where government agencies are easily captured by political interest groups to further the latter's agendas.

On the other hand, as sociopolitical embeddedness involves both opportunities for and constraints on organizations, the combination of the two types of ties can also give rise to additional costs to focal companies. Our earlier discussion implies that ownership ties will on balance be beneficial when the government acts as a minority shareholder. The addition of politically-connected boards and TMTs may mean political forces have a greater say in the corporate governance process. As a result, the greater bargaining power of political agents vis-à-vis private shareholders can facilitate excessive appropriation of firm surplus, thus resulting in extra loss of firm value. In sum, there are both benefits and costs of combining the two types of political ties, but extant literature is silent on when the benefits will outweigh the costs or vice versa. We add greater specificity to this issue by examining how this political tie configuration will impact firm value in the context of adverse political shocks.

When a shock shakes the incumbent elite power bases to which the focal firms are attached, the original overlap between personal ties and organizational ties will disappear. While managerial linkages to the ousted political group have been effectively terminated, firms' ownership linkages to political institutions are inherited by the incoming political group. In this context, although guilt by personal association can invite subsequent discrimination against focal firms from the new political forces, its severity can be mitigated by the minority ownership stakes held by government agencies and SOEs. That is, the instrumental value of ownership stakes makes new elite groups hesitant to terminate resource exchanges between the two parties and self-cannibalize the focal companies. Thus, compared to firms connected only through

managerial ties, ownership ties to state organizations can serve as a buffer against the ‘social liabilities’ associated with personal connections by helping reconstitute the broken business-government linkages after adverse shocks. Hence:

Hypothesis 3: In the face of adverse shocks on a corporate political network, government ownership ties to this network through the holding of minority ownership stakes in focal firms will positively moderate the negative association between managerial political ties and firm value.

EMPIRICAL SETTING

Political connections have salient geographical origins (Siegel, 2007; Faccio and Parsley, 2009), and focusing on local political ties reduces extraneous variation arising from connections to other political networks. Our empirical setting is Shanghai, the most developed city in Mainland China. The local political economy in Shanghai makes the event an ideal context. While there is a high cross-regional rotation of local government officials in China, Shanghai remained an exception. Typical of the vast majority of Shanghai government officials, Chen Liangyu spent his entire public-sector career in Shanghai, starting from a state-owned factory manager before becoming a senior official in the municipal government in the 1990s, and then municipal Party secretary, the city’s first-in-charge, and a member of China’s ruling Communist Party Politburo since 2002.

Political factionalism is a defining feature of Chinese politics (Shih, 2008). Chen was widely believed to be a key member of the Shanghai-based political clique¹ in the Chinese Communist Party, an informal group of officials rising to prominence under the patronage of Jiang Zemin, China’s former leader, who was once mayor and Party secretary of the city and cultivated it as his power base. According to the *Wall Street Journal* (2007), this cohesive local clique facilitated the emergence of what was known as ‘Shanghai Inc.’: ‘giant construction projects got funded from public coffers;

choice assets moved out of state hands in elaborate transactions; and plum contracts went to the well-connected.’

However, President Hu Jintao and Premier Wen Jiaobao, the successors of Jiang, had few prior Shanghai links but competing relationships with members of the clique. The purge of Chen by the central government, consequently, represented a big blow not only to his close friends, but to the *whole* political network in Shanghai. Representing China’s biggest political shakeup in the 2000s, ‘Mr Chen’s dismissal is being widely interpreted as Hu Jintao strengthening his position both within the party and the country as a whole.’ (*BBC News*, 2006)

A detailed timeline of this political event is shown in Table 1. On Monday, September 25, 2006, the state media announced the dismissal and detention of Chen in Beijing the day before, on the ground of his involvement in the Shanghai pension scandal. It was reported that at least RMB 3.2 billion (\$427 million), or about one third of the city’s pension fund, had been illegally diverted to politically-connected firms and obscure private holding companies for investment in real estate and infrastructure projects (such as the companies mentioned in Table 1).²

<Insert Table 1 here>

Although the pension scandal had emerged earlier when some businessmen and lower-level Shanghai officials were arrested, this event was largely unexpected by the public: Misuse of public funds was not uncommon in China, thus hardly justifying the arrest of a ruling Politburo member (Sun et al., 2011b). In effect, the scandal has been exploited by the central government to achieve a ‘partial regime change’: Our study of media reports and archival data suggests that no less than 30 senior government officials and SOE executives were dismissed, demoted, or arrested because of this scandal.

Case Illustrations

Anecdotal evidence in the Shanghai corporate sector suggests that politically connected firms were not equally vulnerable to this shock. As noted in Table 1, the Shanghai Electric Group Co. Ltd. was directly involved in the pension scandal, as three of its senior executives – Wang Chengming, Han Guozhang, and Zhang Rongkun – were Chen’s close friends and actively engaged in the fund diversion activities. Despite the fact that they were jailed after the event, the listed company did not suffer political retaliation as government ownership stakes provide a crucial buffer against the shock. Inspection of its financial reports reveals that it did not experience reduction in bank financing from the state-controlled banking system after the shock.

In contrast, another politically connected company – Shanghai Hainiao Development Co. Ltd. – was much less fortunate. A Shanghai-based property developer, the firm was controlled by Zhou Zhengyi, a business tycoon closely connected to Chen and his family. His real estate business received tremendous support from the municipal government in supplying plots in the city’s central locations. The downfall of Chen, however, led to the collapse of Zhou’s business empire. He was sentenced to 16 years in prison and his company was no longer able to obtain any land supply from the local government. Post hoc analysis of its annual reports finds plummeting profitability and external financing after 2006. Although various factors can account for the tale of the two firms, one crucial difference was the presence or absence of government ownership linkages. While the Shanghai government held ownership stakes in the former company, Zhou did not develop ownership ties to local government agencies, which might have been able to buffer this adverse shock.

DATA AND VARIABLES

In June 2006, 162 companies were headquartered in Shanghai and listed on the Chinese stock market, including stock exchanges in Hong Kong, Shanghai, and

Shenzhen. Stock price, accounting, and ownership data for these firms were obtained from the Chinese Stock Market and Accounting Research (CSMAR) database. After deleting firms without necessary data to calculate cumulative abnormal returns (CARs), we have 154 firms for our empirical analysis.

Dependent variables

The event study approach can largely obviate the endogeneity problem as studies using adverse shocks as ‘quasi-experiments’³ can obtain a reasonably clean measure of the valuation effects of political ties. The resulting changes in market-adjusted stock returns can serve as an estimate of the *lost value* of various types of ties (Fisman, 2001). As a negative shock damages the power base of the prior network to which firms are attached, different tie configurations will exhibit varying degrees of resilience to potential retaliation by the rival network, which should be manifested through investor responses.

Standard event study methodology (McWilliams and Siegel, 1997) is used to estimate companies’ cumulative abnormal returns (CARs). We first run the following market model for daily returns: $R_{it} = \alpha + \beta_i R_{mt} + \varepsilon_{it}$, where R_{it} is the rate of return for stock i at time t , and R_{mt} is the rate of return on the market portfolio m at time t . The estimated intercept and coefficient prior to the unanticipated event are applied to calculate the abnormal return $[AR_{it} = R_{it} - (\hat{\alpha} + \hat{\beta}R_{mt})]$ for each company.

Regarding the choice of event windows, we treat September 25, 2006 (Monday) as day 0, when the arrest of Chen in Beijing on September 24 was released to the public. Information leakage before September 24 is of minor concern since the purge was kept strictly confidential. For example, Chen made high-profile media exposure on the evening of September 23 – watching the Shanghai Golden Grand Prix, an international track and field game hosted in Shanghai, with other senior municipal

officials (see Table 1). As such, we follow Faccio and Parsley (2009) by using event windows starting from trading day -1 (September 22, 2006) to allow for potential pre-event leakage in calculating the CARs. Event windows starting from day 0 also yield very similar results.

Further, we agree with Faccio and Parsley (2009) that there is no reason to extend event windows further prior to such a sudden event. This is not least because of the confounding information released on day -2 (September 21), when the media reported that Chen accompanied national government leaders in receiving foreign delegates in Shanghai on the same day. Without hindsight, this information would have suggested to investors that Chen was politically safe, at least in the near term.

With respect to the ending days of the event windows, a very long event window is hard to justify because of potential confounding effects (McWilliams and Siegel, 1997). Meanwhile, we allow for moderate post-event drift in this context: First, short-window event studies may produce biased inferences from highly complex, infrequent events (Oler et al., 2008). The media in China is strictly state-controlled so that most relevant information and political implications of this event cannot be openly discussed. Therefore domestic investors need more time to digest its delicate nature. Second, as shown in Table 1, some of Chen's associates were arrested on September 28 (day +3). This information served to reinforce investor belief that the event was targeted at the whole local political network in Shanghai. Consequently, CARs of each company over the event windows (-1, 2) and (-1, 3) – $CAR_i(-1, 2)$ and $CAR_i(-1, 3)$ – are obtained through aggregation of AR_i for each day.

Independent variables

Managerial political ties. We manually collected career information on 2,577 TMT/board members in the 154 firms, comprising all those for whom information was disclosed in their companies' annual reports and other archival sources. They

included board directors, senior executives without board membership, and members of companies' supervisory boards. Consistent with previous literature (Hillman *et al.*, 1999; Faccio, 2006; Sun *et al.*, 2011b), a firm is deemed connected to the Shanghai-based political network if at least one TMT/board member had been a former government official⁴ or was currently a member in legislative bodies in Shanghai. This specification captures all personal links to the political network that can be identified and verified by investors. We use a binary variable PERSON_TIE to denote personal connections to the local network. It equals 1 if a company had former official(s) from the Shanghai government or current member(s) in municipal legislative bodies as TMT/board member(s) at the time of the event, 0 otherwise.

To capture the strength of personal-level political ties, we developed a new firm-level index measuring the degree of a firm's proximity to the local political power. Building on Kim and colleagues' (2012) political alignment index, our firm-level index is constructed by accounting for two important dimensions of a firm's political connectedness. First, a firm will have a closer local political connection if its TMT/board member(s) had a higher political status/rank in the local state authority. Second, the connection will be stronger if the connected person holds a more important position with greater decision-making power in the company. Specifically, we created the index as below:

$$\text{PERSON_INDEX} = (1/2) * \text{Gov_Rank} + (1/2) * \text{Company_Position}$$

where *Gov_Rank* is valued in accordance with the seniority of the highest government post that a company's TMT/board member once had. We followed the official ranks of the Chinese bureaucracy to divide the connected people into three groups: For companies whose connected executives once had a position below the division level,⁵ we assigned a value of 1 to *Gov_Rank*. Moving up the hierarchy is the division (*chu*) level officials who play a significant, albeit operational, role in government's management of business affairs, so a value of 2 is assigned to *Gov_Rank* for firms in

this category. Since top positions in the Shanghai government are at the ministry (*bu* in Chinese) level and bureau (*ju* or *si*) level, *Gov_Rank* is assigned a value of 3 if the firm has the very top connections.⁶

The second part of the index – *Company_Position* – concerns the company decision-making power held by the politically connected. Again we divide the connected people into three categories: *Company_Position* is assigned a value of 1 if the politically connected person does not have board membership. That is, s/he was an executive in charge of operational/functional aspects of the business or sitting on its supervisory board. While Chinese regulations mandate the establishment of two-tier boards in all listed companies, Chinese supervisory boards normally play a symbolic role. *Company_Position* equals 2 if the politically connected person acted as an independent director. Imitating the Anglo-American corporate governance system, the Chinese regulatory authority mandates the appointment of independent directors and grants them considerable power in corporate governance, such as chairing board sub-committees and ratifying major business transactions. Finally, *Company_Position* equals 3 if the politically connected was an executive board director, i.e. a corporate insider. In other words, connections are expected to generate more impacts when held by people with greater decision rights within a firm.

Government ownership ties. Based on prior literature (Inoue et al., 2013; Vaaler and Schrage, 2009), we measure the strength of political ownership ties by using a continuous variable *SHG_SHARE*, which is the percentage of minority equity stakes held by Shanghai government agencies via their SOEs. Since the early 2000s, most Chinese government agencies have tended to hold ownership stakes in the downstream listed companies through their SOEs. We have confirmed from our data analysis that this is indeed the case: Government agencies do not act as immediate shareholders of the Shanghai-based publicly traded corporations. As listed companies in China are required to disclose their ten largest shareholders, we manually identify if minority stake holders were local SOEs in each company. This was accomplished by

careful study of archival information and by assistance from equity analysts with deep knowledge of these companies.

Government minority stakes are found in 81 sample companies. Tracing the origin of these stakes by checking the companies' IPO prospectuses and merger and acquisition records confirms that both residual government stakes and original government investment existed in these firms.

Control variables

De facto Shanghai SOEs. If a Shanghai-based SOE holds a majority equity stake in a downstream listed firm, we treat the listed company as a *de facto* SOE affiliated to the local government. A dummy variable SH_SOE takes the value of 1 if the Shanghai government owns more than 50% of the listed company's total shares outstanding via its SOE(s), 0 otherwise. We find 28 companies in this category.

Central government control and connections. Since the event implies a crackdown on the local political clique, a firm's personal and ownership ties to central government need to be controlled for. We use CEN_CONTROL to denote firms controlled by central government agencies. This equals 1 if a company disclosed that a central SOE was its largest shareholder, 0 otherwise. Similarly, we use CEN_PERSON to denote firms that had personal connections to central government agencies, equaling 1 if a company had former central government official(s) being TMT/board member(s) at the time of the event, 0 otherwise.

Other control variables. SIZE is the natural logarithm of sales revenues in 2005. AGE is the number of years since incorporation in China. ROA is return on assets in 2005. P/B Ratio is the ratio of a firm's market value to its book value at year-end 2005. INDUSTRY is the standard dummy variables controlling for industry-specific effects. MARKET TYPE is a dummy variable controlling for the specific stock exchange on

which a company was traded.

Testing a null hypothesis

Testing the null form hypothesis 2 entails a power analysis that has been applied in behavioral sciences (Cohen, 1988, 1990, 1992) and management research (Lane et al., 1998; Peng, 2004). It is well known that failure to find a statistically significant estimated coefficient does not warrant the conclusion that the null hypothesis is true. However, as pointed out by Cohen (1990), the null can be “accepted” if the hypothesized effect is found to be of no more than negligible or trivial size by virtue of a power analysis.

Thus, this analysis begs the question of when the effect size can be treated as ‘nontrivial’ in testing a null. Cohen (1992) proposed operational definitions of large, medium, and small effect sizes. In view of our event study context involving observations from outside investors, we find it suitable to adopt a medium effect size, which ‘represents an effect likely to be visible to the naked eye of a careful observer’ (p. 156). Following Table 1 in Cohen (1992) and Lane et al. (1998), we consider an effect to be trivial if the resultant R^2 from our power analysis is smaller than 0.13, the medium effect size.

To proceed with the power analysis, we further set the significance level α (the type I error risk) to be equal to 0.05 or 0.01 and the power of the test to be 0.8 (so the type II error risk $\beta = 0.2$), which are ‘a convention proposed for general use’ (Cohen, 1992: 156). Finally, the power analysis needs to determine the sample size necessary to attain the above power for the specified α and β . Referring to Table 2 in Cohen (1992), we note that our sample size ($n = 154$) is larger than all the minimum sample sizes required to test our null hypothesis. Hence, our null hypothesis will receive empirical support if the effect size is found to be greater than the R^2 in association with the medium effect size, given the specified α and β and the large-enough

sample size.

RESULTS

Stock market responses are shown in Table 2. For the full sample, the sign and the significance of the CARs are very sensitive to the event window chosen, with no consistent result emerging. The table also presents a classification of sample firms into two broad categories: Those with personal connections to and/or equity stakes held by the local political authority and those without. Clearly, the stock market on average discounted the politically-embedded group with a significant decline in CARs ranging from 1.4% to 2.2% over the event windows ending on day +3 or +4, when the purge of other Shanghai officials became publicly known. These results are greater than the percentage losses reported in some previous studies of negative events (e.g., Fisman (2001, -0.95%) and Faccio & Parsley (2009, -1.7%)).

<Insert Table 2 here>

Using CAR (-1, 4) as a case to illustrate the monetary value of the negative impact, the market-adjusted loss of 2.1% for the 127 politically connected companies is equivalent to a reduction of 10.59 billion RMB (\$1.33 billion) in these companies' market value over these six trading days, which accounts for about 1% of Shanghai's GDP in 2006. The magnitude of this shock is more substantial in proportional terms than estimates in some prior studies: Jayachandran (2006) reports that the loss of market capitalization in U.S. companies previously making donations to the Republican Party amounted to \$76.9 billion, or 0.76% of U.S. GDP in 2001, when Senator Jeffords' unexpected defection from the Republican Party tipped the control of the U.S. Senate to the Democrats. More dramatically, a recent study of the impact of the rise of the Nazis in Germany suggests that the market value appreciation enjoyed by companies connected with the Nazi movement in early 1933 amounted to 0.71% of German GDP in the same year (Ferguson and Voth, 2008).

Table 3 presents descriptive statistics and pair-wise correlations among the variables used in subsequent regressions, with several noteworthy features. First, the mean of the binary variable PERSON_TIE is 68.8%, indicating that a majority of sample firms maintained personal connections to the local political authority. The mean of SHG_SHARE is 11.5%, suggesting that the Shanghai government held substantial but non-controlling stakes in 81 of our 154 sample companies. Second, while the negative correlation between CARs and SHG_SHARE is not significant, both PERSON_TIE and PERSON_INDEX are negatively correlated with CARs at 1% or 5% significance levels. Third, both CEN_CONTROL and CEN_PERSON exhibit strong negative correlations with various measures of local political ties (i.e., SHG_SHARE and PERSON_TIE). This suggests that both central and local political ties cluster around different groups of companies, so that few companies simultaneously develop personal and/or ownership ties to both local and central authorities. Finally, the variance inflation factors (VIFs) of all the explanatory variables are smaller than 2.5, far below the conventional cut-off level, suggesting that multicollinearity is not a concern in the empirical analysis.

<Insert Table 3 here>

We perform multivariate regressions investigating the relationship of firm-level CAR (-1, 2) and CAR (-1, 3) to the composition of local political ties, with results shown in Table 4. Models (1) and (5) only contain control variables. The positive effect of CEN_CONTROL aside, no other variables show significant effects on CARs.

<Insert Table 4 here>

Regressions in the remaining models concern the valuation effects of different types and compositions of local political ties. Strongly supporting Hypothesis 1, the marginal effect on CARs of managerial ties to the Shanghai-based political network is

significantly negative. When we use the continuous measurement of personal political ties, consistent supportive results are present in models (2) and (6): Noting that a firm's PERSON_INDEX is zero if it was not connected to the local government through personal connections, a one-unit increase in a firm's political proximity to the local regime would lead to about a 0.8% discount in CAR (-1, 2) ($p < 0.05$).

Regarding the marginal valuation effect of SHG_SHARE, the estimated coefficients in models (2) and (6) are statistically insignificant, implying that the valuation effect of government ownership ties is insignificantly different from zero following the shock. This is a necessary but insufficient condition to “accept” the null form hypothesis 2. In models (3), (4), (7), and (8), we test Hypothesis 3 regarding interactions between managerial ties and ownership ties. Irrespective of using binary or continuous measures of managerial political ties, regression results offer unambiguous support for this hypothesis. That is, government ownership ties play a significant moderating role of buffering against the negative shocks on companies having managerial connections to the local political network.

Table 5 presents the results of the power analysis testing the null hypothesis 2. In models (9), (10), (13), and (14), we regress CAR (-1, 2) and CAR (-1, 3) simply on the measures of the two key independent variables. While the managerial political ties are negatively correlated with the CARs, there is again no statistical association between government ownership ties and the CARs. Moreover, the corresponding R^2 's are much smaller than the medium size threshold – 0.13, so we can conclude that hypothesis 2 can be accepted with the power of the test greater than 0.8 and the risk of type II error smaller than 0.2. In the rest of the models in Table 5, we add more control variables regarding other political linkages. Again, the results remain very similar, offering consistent support for hypothesis 2.

<Insert Table 5 here>

Robustness Checks

The portfolio approach. Besides conventional regressions of CARs on firm characteristics, the portfolio approach is also used in the finance literature. A recent survey of event studies (Kothari and Warner, 2007: 19-20) advocates combining the two methods and checking if there is broad consistency so as to enhance the robustness of future event studies. Thus, we employ the portfolio approach to investigate if investors could have reaped significant stock returns by forming certain trading portfolios in line with the configuration of the political ties in our sample. Since the adverse shock is expected to generate a detrimental effect on firms with managerial and/or ownership ties to the Shanghai government, a hypothetical prescient investor should be able to earn significant returns by taking advantage of such information over (-1, 2) and (-1, 3).

Specifically, we construct three equal-weighted portfolios during the event periods: The first is long (buy shares) in companies without personal connections to the Shanghai government and short (sell shares) in those with personal ties; the second is long in companies whose PERSON_INDEX is higher than or equal to the median (i.e., 2.5), and short in those with no personal ties (i.e., PERSON_INDEX = 0); the third is long in companies without minority ownership stakes held by the Shanghai government (SHG_SHARE), and short in those with minority stakes. To implement the portfolio time-series regressions, we follow Berkman et al. (2010) to specify the following models:

$$\begin{aligned} & R(\text{Without } PERSON_TIE_t) - R(\text{With } PERSON_TIE_t) \\ & = \beta_0 + \beta_1 EVENT + \beta_2 MARKET_RETURN_t + \varepsilon_t \end{aligned} \quad (1)$$

$$\begin{aligned} & R(\text{Min } PERSON_INDEX_t) - R(\text{High } PERSON_INDEX_t) \\ & = \beta_0 + \beta_1 EVENT + \beta_2 MARKET_RETURN_t + \varepsilon_t \end{aligned} \quad (2)$$

$$\begin{aligned}
& R(\text{Without } SHG_SHARE_t) - R(\text{with } SHG_SHARE_t) \\
& = \beta_0 + \beta_1 EVENT + \beta_2 MARKET_RETURN_t + \varepsilon_t \quad (3)
\end{aligned}$$

$R(\text{Without } PERSON_TIE_t)$ and $R(\text{With } PERSON_TIE_t)$ are the respective returns for day t on firms without and with personal-level political ties; $R(\text{Min } PERSON_INDEX_t)$ and $R(\text{High } PERSON_INDEX_t)$ are respective returns for day t on firms whose $PERSON_INDEX$ are zero and no smaller than 2.5 in the sample; $R(\text{Without } SHG_SHARE_t)$ and $R(\text{With } SHG_SHARE_t)$ are the respective returns for day t on firms without and with government minority stakes. $EVENT$ is a dummy variable equaling $1/n$ for the dates within the event window of n days, and 0 otherwise, where $n = 4$ in the window $(-1, 2)$ and $n = 5$ in the window $(-1, 3)$. $MARKET_RETURN_t$ is the return for day t on the value-weighted market portfolio of firms listed on the Chinese stock exchanges. Each model is estimated over all the 241 trading days in 2006 (i.e., $t = 1, \dots, 241$).

Table 6 reports the performances of the three portfolios by showing the estimates of β_1 with different firm samples. Hypothesis 1 receives support in the whole sample: An investor holding the first two portfolios during the event periods would reap positive returns, the statistical significance of which is present in most cases. For example, if an investor had longed the stocks of companies with managerial political ties to the Shanghai government and meanwhile shorted the stocks without these ties during the event window $(-1, 2)$, s/he could have earned a 2.3% investment return over the four trading days (equivalent to 144% of annualized investment return). Moreover, this positive return could have been increased to 4.9% (equivalent to 295% of annualized return), had s/he concentrated on a subsample without Shanghai government equity stakes over the same event window.

In contrast, investors holding the third portfolio would have failed to reap any significant returns during the event windows. This is consistent with Hypothesis 2, which suggests that trading on the basis of minority ownership stakes is unlikely to

yield investment returns. This result also corroborates the support for Hypothesis 2 reported above using the power analysis.

<Insert Table 6 here>

In support of Hypothesis 3, the first two portfolios would have failed to generate positive returns if the companies traded had been constrained to those with ownership ties to the Shanghai government during the event periods. The estimated coefficients – the investment returns – in the two subsamples are statistically indistinguishable from zero. This suggests that, facing this political shock, minority government ownership plays a significant buffering role for companies holding managerial ties to the local political authority. In sum, results of the portfolio approach are consistent with those in the preceding regression analysis and provide further corroborating evidence.

Alternative definition of government ownership ties. We also consider the case when Shanghai government agencies held minority stakes but remained the largest shareholders via their SOEs in the listed firms. If we assume that these companies were still under operating control by the largest shareholders, these sample companies may also be classified as de facto Shanghai SOEs. Thus, we narrow down our original definition of government ownership ties to companies where local SOEs did not act as their largest shareholders. Specifically, a binary variable OWN_TIE is equal to 1 if a listed company's largest shareholder is unrelated to the Shanghai government, but one or several Shanghai-based SOEs held ownership blocks in the company, 0 otherwise. Correspondingly, the control variable SH_SOE now takes the value of 1 not only for firms with majority stakes held by Shanghai-based SOEs, but also for those with local SOEs acting as minority largest shareholders.

On the basis of this new classification, we re-tested the second and third hypotheses through the conventional regression analysis, the power analysis, and the portfolio approach. All the estimation results are very similar to those reported in Tables 4-6.

Due to space limit, these results are not reported here but are available upon request.

DISCUSSION AND CONCLUSION

Prior research on corporate political ties recognizes the general contingency of their value for focal firms, but falls short of examining the heterogeneity of these ties. Emerging economies are characterized by political hazards that are difficult to regulate by institutional checks and balances. As a result, firms need to develop a deeper understanding of how different corporate political ties vary in their vulnerability and resilience to negative shocks. To this end, we unpack the exchange process embedded in different types and combinations of political ties. We have developed and tested hypotheses delineating how specific compositions of political ties are associated with different valuation impacts arising from the most dramatic political shock in China in the 2000s.

Theoretical Implications

Students of interorganizational relationships have long called for more in-depth studies to distinguish the respective mechanisms regulating personal-level and organizational-level embeddedness (Barden and Mitchell, 2007; Brass et al., 2004; Zaheer et al., 2010). However, attempts to understand the heterogeneity of corporate political ties and its impacts on corporate outcomes remain virtually absent in the literature. Most political connection research overlooks that firms are typically embedded in a political constellation encompassing different levels/dimensions of business-government exchanges. This approach, however, risks theoretical misspecification and misleading empirical findings. By simultaneously examining managerial political ties, government ownership ties, and their interactions, we investigate how nodal multiplexity of corporate political ties influences firm outcomes in the emerging economy context.

The importance of such heterogeneity would be less critical if adverse political shocks did not characterize emerging economies. Under political stability, interpersonal exchanges embedded in managerial political ties and interorganizational exchanges embedded in government ownership ties are oftentimes intertwined and overlapping, as political elites are also in charge of public authorities. It is, however, in the presence of adverse shocks that the criticality of political tie heterogeneity manifests itself for focal firms.

Specifically, the value of managerial political ties can be quickly erased after the shock that damages the local political network. ‘Guilt by association’ makes it hard to reconstitute these broken ties in the near term and may invite unfavorable treatment from rival political groups. In comparison, the exchange of resources and favors involves negligible personal and socioemotional elements at the interorganizational level. Absent allies of political opponents holding executive/board positions, firms with only ownership ties are less susceptible to ‘guilt by association’ and find it easier to realign themselves with incoming political elites. Furthermore, for focal firms with managerial connections, our study suggests that ownership linkages help alleviate the negative impacts of personal-level liabilities. Thus, a combination of personal and organizational ties to local political authority is instrumental in managing the risk-return duality prevailing in emerging economies.

In sum, our study integrates the political embeddedness perspective and the literature on emerging economy political institutions to unravel a more nuanced picture of political tie utilization. In doing so, we extend the conventional perspective adopted in developed economies, which portrays political ties as facilitators of business-government transactions on an implicit political market (Bonardi et al., 2005; Kingsley et al., 2012). This paves the way for more disaggregated, multilevel investigations into the impacts of political embeddedness on firm outcomes across different contexts.

Our study also has important implications for existing studies of corporate political activity through the political resources lens. While corporate political ties are a crucial element of firm-specific political resources to generate rents (Dahan, 2005; Frynas et al., 2006; Oliver and Holzinger, 2008), prior research largely neglects the heterogeneity of resources that can be supplied by different types and bundles of political ties. We have taken a critical step forward by examining both the direct and interactive effects of two types of political ties. The results reveal that minority government ownership acts as a buffer against the deleterious valuation effect that personal ties can have in the aftermath of negative political shocks.

Echoing Bonardi's (2011: 250) argument that 'future work on political resources needs to be strongly anchored in a theory of how political environments work,' our study suggests that the value of heterogeneous political ties is contingent on the dynamics of political fragmentation and volatility in emerging economies. The distinct exchange processes underlying personal and organizational linkages imply different rent-generating mechanisms, which in turn give rise to varying degrees of vulnerability/resilience to political perturbations. Therefore, our findings highlight the need to further understand the heterogeneity and bundles of political resources by studying the interactions between different types and compositions of non-market resources and changing non-market environments.

Managerial and Ethical Implications

Our study has profound implications for senior executives doing business in emerging economies. Corporate political ties may reflect focal firms' umbilical cords to the state embedded in past institutional legacies or be deliberately created by focal firms to co-opt powerful political forces. In both cases, adroit management of these ties has proved crucial for firms to navigate the challenging business environments. As recent research hints at (Bonardi, 2011; Sun et al., 2012; Shi et al., 2014) and our present study shows, basing corporate political strategy on a single, however high-profile,

political tie can be particularly risky. Instead, firms may rely on a portfolio of connections to generate the requisite political resources, which themselves differ in nature and function.

Concretely, the prevailing risk-return duality in the non-market environment prompts managers to contemplate strategies of both capturing sizeable government resources and mitigating political risks. While developing personal-based connections with politicians can result in significant benefits for focal firms, they have to be balanced by the vulnerability of the ties to adverse political shocks. Government ownership ties, on the other hand, can play an important risk absorption role in buffering firms from these shocks. Therefore, a combination of personal and organizational ties to the incumbent political regime can be beneficial for focal firms, since they can enjoy their managerial connections absent adverse shocks, while relying on organizational ties to reduce the likelihood of falling victim to unpredictable power struggles.

Closely related to these managerial implications are the broader ethical ramifications for both indigenous and foreign firms operating in emerging economies. The corporate political strategy literature has been criticized as being insensitive to business ethics issues, for some practices are ethically questionable and sometimes border on the corrupt (den Hond et al., 2014; Mantere et al., 2009). While we do not directly address the effects of different types of political ties on corporate reputation, our analysis does imply that political ties are *not* equally subject to ethical problems.

Like all organizations, political institutions have both ‘personal faces’ represented by individual political actors and ‘organizational faces’ endorsed by their collective interests. In reality, firms have resource exchanges with political institutions through both of these interfaces. The presence of faces of political elites in focal firms may raise ethical concerns from the public even under political stability. The problem can be more salient in the presence of adverse shocks, when the legitimacy and images of the focal companies are damaged by their association with certain politicians. In view

of this risk, our research reminds practitioners of the importance of managing government relations through organizational-level interfaces. Keeping some distance from personal-level agendas but highlighting organizational-level collaboration can at least mitigate possible ethical concerns and contribute to more sustainable business-government exchanges. Hence, development of reciprocal relationships with the state should be anchored more on the alignment of organizational objectives than on particularistic favor exchanges with individual political leaders. In emerging economies, this ethical challenge seems likely to persist while institutional voids remain and vary between different economies as they develop their institutional infrastructures at different rates (Hoskisson et al., 2013).

Limitations and Future Research

Our study provides a snapshot of how the composition of heterogeneous political ties impact firm value upon a high-profile political shock in the world's largest emerging economy. While we have undertaken a careful analysis of the relevant qualitative information related to this shock, it is evident that more insights can be generated in future by longitudinal qualitative studies which trace the evolution of how firms develop, exploit, or terminate different types and combinations of political ties both in stable periods and following shocks. Such research will enrich our initial finding and deepen our knowledge about how the underlying mechanisms regulating the various political ties co-evolve with the business and institutional environments.

As we are interested in comparing and contrasting interpersonal and interorganizational ties between business and government, we focused on managerial political and government ownership ties because they are salient representations of these broader constructs in the current research context. However, we do not claim that this classification exhausts the typology of political tie heterogeneity in both personal and organizational dimensions. At the personal level, our measure of managerial ties is appropriate for an event study since it incorporates all the verifiable

information that an outside investor can garner about the personal linkages to the local regime that the listed companies could have. In other contexts, however, we may need to find ways of identifying more informal linkages between business people and politicians. This is an empirical challenge that future qualitative and survey research can help to tackle.

With respect to ownership ties, we acknowledge that some are not strategically created by focal firms but are residual government holdings following privatization. Clearly, basing a nonmarket strategy on government ownership ties may have very limited scope in many circumstances. On the other hand, the *strategic* retention of minority stakes signals that the focal firms are instrumental in helping achieve a regime's financial or policy goals (Vaaler and Schrage, 2009). Hence, firms can exploit such strategic interdependence and manage the residual holdings as a certain type of political resources. That being said, ownership ties are not the only way through which business firms and governments interact at the organizational level. Affiliation to government agencies (Wang et al., 2012), participation in quasi-government industry associations (Jia, 2014), and joint ventures established between multinationals and host-country SOEs (Sun et al., 2010a) are among the various examples of organizational linkages between firms and the state. Future research might usefully examine how different types of these linkages interact with personal level political ties to shape firm outcomes.

Finally, we do not address the feasibility and consequences of a scenario where focal firms simultaneously develop multiple ties to competing political groups. Few companies in our sample had personal and/or ownership ties to both local and central authorities at the same time. However, this does not preclude the presence of 'bets-hedging' ties to rival networks in China and other emerging economies (Dieleman and Boddewyn, 2012; Zhu and Chung, 2014). Future studies can contribute to the political strategy literature by developing datasets focused on achieving a deeper understanding of the formation and performance consequences of

different political tie configurations.

In sum, corporate political ties are widespread around the world, but compared to interfirm network embeddedness, we know much less about how the content and structure of political embeddedness shape firm outcomes. By disentangling managerial ties to political actors and ownership ties to political institutions and examining their interactions, we hope our study can open the door to future research that unravels the nuances of corporate political activities through political tie utilization across different institutional contexts.

NOTES

[1] For more information, please visit http://en.wikipedia.org/wiki/Shanghai_clique.

[2] More information about this scandal can be accessed by visiting the following websites: http://en.wikipedia.org/wiki/Chen_Liangyu and http://en.wikipedia.org/wiki/Shanghai_pension_scandal.

[3] They refer to ‘exogenous shocks such as policy changes or other unanticipated events that enable identification of causal effects’ (Oxley *et al.*, 2010: 384).

[4] The Civil Servant Law of China stipulates that a public servant not hold a concurrent post in any profit-making organization. Consistent with the legal requirement, we did not find any acting Shanghai government officials sitting on the boards or holding executive positions in the sample companies.

[5] This means that these people were low-rank bureaucrats before moving to the business sector.

[6] There are few connections at the ministry level in our sample, so we group the two levels of observations. Bureau-level officials in Shanghai wield enormous power over business activities, such as the approval of land use and investment projects.

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Table 1 The Timeline of the Shanghai Pension Scandal

Time	Events
July 17 2006	(1) Zhu Junyi, Head of the Labor and Social Security Bureau in the Shanghai Municipal Government detained for investigating the misuse of the city pension fund.
	(2) Zhang Rongkun, Board Chairman of Fuxi Investment Holdings Corporation detained by police. It was revealed that a large amount of the city's pension fund had been illicitly funneled to this private holding company for its investment in real estate and infrastructure projects in Shanghai.
August 8 2006	Han Guozhang, Deputy CEO of Shanghai Electric Group Co. Ltd. detained for questioning. Zhang Rongkun was the company's vice board chairman and Fuxi Investment Holdings became the second largest shareholder of this public company during its privatization process in 2004. It was revealed that the funds (RMB 0.96 billion) used to acquire the company stakes originated largely from the city's pension fund.
August 14 2006	Wang Chengming, Board Chairman and CEO of Shanghai Electric Group Co. Ltd. detained in relation to the pension fund scandal.
August 24 2006	Qin Yu, Governor of Baoshan District in Shanghai detained for interrogation. He was Chen's former secretary and widely believed to be Chen's protégé.
September 23 2006	Chen and other Shanghai city officials watched the Shanghai Golden Grand Prix, an international track and field game, in the evening. This is the last time Chen exposed himself to the public before his ouster.
September 24 2006	Chen was informed to attend the Politburo meeting in Beijing, where he was detained for corruption charges and removed from all the official posts.
September 25 2006	The news was released by Xinhua News, the official media in China.
September 28 2006	(1) Sun Luyi, Vice-Secretary-General of Shanghai Communist Party Committee, was detained for interrogation.
	(2) Wang Chengming and a CEO of a local SOE (a close friend of Chen's) officially removed from their posts.
April 11 2008	Chen sentenced to 18 years in prison on charges of financial fraud, abuse of power, and accepting bribery.

Source: The authors' collection of archival data and media reports.

Table 2 Cumulative Abnormal Returns (CARs) in Shanghai-based Publicly Listed Companies

Event Window	Full Sample (n = 154)		Companies connected to local political networks (n = 127)		Companies lacking local political embeddedness (n = 27)	
	CAR	t-statistic	CAR	t-statistic	CAR	t-statistic
-1, 1	0.005	1.235	-0.001	-0.173	0.033**	2.429
-1, 2	0.002	0.473	-0.005	-1.155	0.034***	2.643
-1, 3	-0.007	-1.474	-0.014***	-2.838	0.024*	1.624
-1, 4	-0.015***	-2.964	-0.021***	-4.217	0.016	1.139
0, 1	0.004	1.119	-0.000	-0.036	0.024**	2.477
0, 2	-0.000	-0.073	-0.006*	-1.627	0.026***	2.736
0, 3	-0.009**	-2.220	-0.014***	-3.269	0.016	1.497
0, 4	-0.017***	-3.962	-0.022***	-4.913	0.009	0.862

Note: *, **, and *** denote significance levels at 10%, 5%, and 1% respectively.

Table 3 Descriptive Statistics and Pearson Correlation Coefficients

	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	VIF
1 CAR(-1,2)	0.002	0.053	1											
2 CAR(-1,3)	-0.007	0.060	0.949	1										
3 AGE	11.305	4.051	-0.070	-0.149	1									2.47
4 ROA	0.032	0.083	-0.288	-0.255	-0.153	1								1.58
5 SIZE	21.060	1.689	-0.106	-0.043	-0.235	0.331	1							1.65
6 P/B Ratio	3.150	4.383	-0.092	-0.121	0.063	-0.087	-0.155	1						1.49
7 CEN_CONTROL	0.234	0.424	0.144	0.142	-0.266	0.079	0.124	-0.132	1					1.87
8 CEN_PERSON	0.260	0.440	0.064	0.045	-0.008	-0.032	0.103	-0.033	0.373	1				1.39
9 SH_SOE	0.182	0.384	-0.092	-0.065	-0.094	0.158	0.149	0.060	-0.221	-0.164	1			1.88
10 SHG_SHARE	0.115	0.159	-0.036	-0.028	0.134	-0.052	0.034	-0.060	-0.333	-0.199	-0.340	1		1.89
11 PERSON_TIE	0.688	0.464	-0.213	-0.159	0.075	0.188	0.168	-0.049	-0.258	-0.305	0.245	0.284	1	1.58
12 PERSON_INDEX	1.795	1.264	-0.216	-0.155	0.060	0.161	0.197	-0.051	-0.264	-0.286	0.277	0.286	0.959	1.60

Note: Correlations with absolute values greater than 0.155 are significant at 5% level. (N=154)

Table 4 Regressions of CARs on Political Tie Compositions

	CAR (-1, 2)				CAR (-1, 3)			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
INTERCEPT	-0.036(-0.492)	-0.034(-0.468)	-0.016(-0.215)	-0.018(-0.243)	-0.088(-1.206)	-0.086(-1.190)	-0.066(-0.914)	-0.068(-0.942)
AGE	0.001(0.815)	0.001(1.063)	0.001(0.877)	0.001(0.852)	0.000(0.353)	0.001(0.546)	0.000(0.333)	0.000(0.325)
ROA	-0.091*(-1.689)	-0.074(-1.380)	-0.080(-1.513)	-0.074(-1.371)	-0.083(-1.580)	-0.070(-1.326)	-0.077(-1.479)	-0.070(-1.335)
SIZE	-0.002(-0.829)	-0.001(-0.477)	-0.002(-0.716)	-0.002(-0.800)	-0.001(-0.280)	-0.000(-0.006)	-0.001(-0.271)	-0.001(-0.333)
P/B Ratio	-0.000(-0.415)	-0.001(-0.564)	-0.001(-0.521)	-0.000(-0.457)	-0.001(-0.619)	-0.001(-0.728)	-0.001(-0.684)	-0.001(-0.636)
CEN_CONTROL	0.021**(1.984)	0.020*(1.723)	0.018(1.618)	0.019*(1.687)	0.021**(2.000)	0.020*(1.779)	0.019*(1.667)	0.020*(1.740)
CEN_PERSON	-0.004(-0.408)	-0.008(-0.817)	-0.007(-0.699)	-0.007(-0.710)	-0.005(-0.593)	-0.009(-0.899)	-0.007(-0.771)	-0.007(-0.796)
SH_SOE	0.001(0.138)	0.007(0.543)	0.014(1.078)	0.012(0.899)	0.002(0.153)	0.006(0.506)	0.014(1.113)	0.012(0.960)
PERSON_TIE				-0.029***(-2.674)				-0.027**(-2.524)
PERSON_INDEX		-0.008**(-2.096)	-0.012***(-2.917)			-0.006*(-1.685)	-0.011***(-2.706)	
SHG_SHARE		0.012(0.393)	-0.081(-1.517)	-0.078(-1.401)		0.012(0.383)	-0.091*(-1.744)	-0.086(-1.579)
SHG_SHARE* PERSON_TIE				0.122*(1.895)				0.134***(2.126)
SHG_SHARE* PERSON_INDEX			0.049***(2.124)				0.054***(2.394)	
R ²	0.390	0.411	0.431	0.425	0.549	0.559	0.578	0.574
F statistics	3.62***	3.57***	3.70***	3.61***	6.89***	6.49***	6.69***	6.59***

N = 154. *t*-statistics are reported in parentheses, with *, **, and *** mark significance at the 10%, 5%, and 1% levels respectively (two-tailed tests).

All regressions shown in the table have controlled for firms' two-digit industry affiliation and stock exchanges where they were traded.

Table 5 Power Analysis Testing the Null Hypothesis of Government Ownership Ties

	CAR (-1, 2)				CAR (-1, 3)			
	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
INTERCEPT	0.018** (2.400)	0.018** (2.405)	0.013 (1.274)	0.014 (1.342)	0.006 (0.684)	0.007 (0.767)	-0.001 (-0.091)	0.000 (0.027)
SHG_SHARE	0.009 (0.342)	0.009 (0.323)	0.021 (0.629)	0.019 (0.562)	0.007 (0.218)	0.007 (0.224)	0.025 (0.632)	0.024 (0.612)
PERSON_INDEX	-0.009*** (-2.704)		-0.009** (-2.301)		-0.008* (-1.915)		-0.007 (-1.641)	
PERSON_TIE		-0.025*** (-2.664)		-0.024** (-2.273)		-0.021** (-1.961)		-0.020* (-1.701)
CEN_CONTROL			0.015 (1.295)	0.015 (1.291)			0.020 (1.481)	0.020 (1.480)
CEN_PERSON			-0.003 (-0.318)	-0.004 (-0.381)			-0.005 (-0.384)	-0.005 (-0.443)
SH_SOE			0.002 (0.118)	-0.000 (-0.000)			0.004 (0.257)	0.003 (0.201)
R^2	0.047	0.046	0.059	0.058	0.024	0.026	0.039	0.040

N = 154. *t*-statistics are reported in parentheses, with *, **, and *** mark significance at the 10%, 5%, and 1% levels respectively (two-tailed tests).

Table 6 Portfolio Performances by Different Political Tie Compositions

Portfolios	Without PERSON_TIE vs. With PERSON_TIE	Min PERSON_INDEX vs. High PERSON_INDEX	Without SHG_SHARE vs. With SHG_SHARE
<i>Whole sample (N=154)</i>			
(-1,2)	0.023*** (3.110)	0.027*** (4.080)	0.013 (1.370)
(-1,3)	0.019 (1.580)	0.022* (1.850)	0.013 (1.210)
<i>Subsample without Shanghai government equity stakes (N=45)</i>			
(-1,2)	0.049*** (7.940)	0.040** (6.590)	
(-1,3)	0.041** (2.110)	0.030 (1.560)	
<i>Subsample with positive SHG_SHARE (N=81)</i>			
(-1,2)	0.014 (0.700)	0.011 (0.530)	
(-1,3)	0.020 (0.930)	0.019 (0.830)	

T = 241. *t*-statistics are reported in parentheses, with *, **, and *** mark significance at the 10%, 5%, and 1% levels respectively (two-tailed tests).